MOODY'S
INVESTORS SERVICE

Rating Update: Moody's affirms Gallaudet University, DC's A2; outlook stable

Global Credit Research - 25 Apr 2014

$39M rated debt

DISTRICT OF COLUMBIA
Private Colleges & Universities
DC

Opinion

NEW YORK, April 25, 2014 --Moody's Investors Service has affirmed the A2 rating on Gallaudet University's Series 2011 University Revenue Bonds (Gallaudet University Issue) issued by the District of Columbia. The outlook is stable.

RATINGS RATIONALE

Affirmation of the A2 rating with a stable outlook is attributable to Gallaudet University's ("Gallaudet") positive operating performance, strong debt service coverage and modest leverage with a conservative debt structure. The rating is constrained by low financial resources and thin liquidity to cushion operations. While Gallaudet's market niche and high level of federal support have historically been favorable, these factors also pose credit risks given the high reliance on a small segment of potential students and one, majority funding source that has been fairly static.

STRENGTHS

*Management budgets conservatively leading to consistently positive operating margins averaging 2.9% annually from fiscal year (FY) 2011 through FY 2013.

*Federal government support for Gallaudet, amounting to approximately two-thirds of Moody's calculated operating revenue, is generally stable.

*Gallaudet is protected from competition because it is the only liberal arts higher education institution offering programs and support designed for deaf and hard of hearing students and it receives strong federal support to off-set a high cost structure (educational expenses per student of $66,198 compared to the A-rated small private university median of $35,055).

*The university has a manageable debt burden of just 0.24 times debt to revenue and no near-term plans to increase debt, allowing it to maintain favorable debt service coverage.

CHALLENGES

*Low unrestricted and expendable financial resources with just $70.1 million of expendable financial resources in FY 2013 limit Gallaudet's financial flexibility relative to similarly rated private universities.

*Gallaudet's high reliance on federal appropriations, commitment to maintaining affordable tuition and weak gift revenue constrain revenue growth.

*Thin liquidity coupled with revenue concentration from the US federal government, requires careful planning for cash-flow volatility.

*Technological developments for the deaf and hard of hearing, as well as shifts in trends toward mainstream education could negatively impact demand.

DETAILED CREDIT DISCUSSION

RECENT DEVELOPMENTS/RESULTS:

We expect Gallaudet's operating margin to rebound with the restoration of federal funding to $119 million in FY 2014, up from $111 million in FY 2013 when the university experienced a 5.2% cut in line with other federal appropriation cuts due to sequestration. Management's conservative budgeting and ongoing assessment of its financial position led to a Moody's calculated 1.8% operating margin in FY 2013 as a result of savings in compensation expense. In reaction to the cut in federal funding, Gallaudet offered a voluntary retirement plan that will provide operating relief in FY 2014.

To insulate itself against cuts in federal funding, Gallaudet has increased tuition by around 7% annually since FY 2012 after holding tuition flat for the two preceding fiscal years. The university has some pricing flexibility as net tuition per student is relatively modest at $10,991, but its pricing will have to remain competitive compared to the National Technical Institute for the Deaf at Rochester Institute of Technology and other universities to maintain favorable student demand.

We expect enrollment to remain generally stable as it has since the increase in undergraduate admissions standards in fall 2011. Management projects that first-year enrollment in fall 2014 will be slightly higher compared to fall 2013 based on application volume. The university continues to add graduate programs on-campus and on-line, as well as review its undergraduate offerings to remain competitive and increase exposure. These changes will not likely result in material enrollment or revenue growth.

The federal funding mechanisms and policies impacting Gallaudet are included in the Education of the Deaf Act, which is due to be reauthorized in 2014. Historically, there have been no major changes impacting the university, but more intense scrutiny of funding and increased regulations are risks.

Gallaudet continues to evaluate its real estate holdings along 6th Street in Washington, DC, amid increasing commercial development in the neighborhood. The value of the property is not included in the university's financial statements, so sale or ground lease of the land to developers could provide financial gain, revenue diversity or increase marketability to students. We will monitor the credit impact of any potential financial or contractual commitments.

LEGAL SECURITY: The Series 2011 bonds are an unsecured general obligation on the university. There is no debt service reserve fund.

DEBT STRUCTURE: All of Gallaudet's debt is fixed rate and there are no interest rate derivatives.

Outlook

The stable outlook is based on our expectation of continued positive operating margins and healthy debt service coverage, solid student demand and no near-term plans to materially increase debt or draw down reserves for capital projects or other initiatives. We also expect no significant reduction in federal appropriations within the next one to two years.

WHAT COULD MAKE THE RATING GO UP

A rating upgrade could be considered with substantial growth in unrestricted liquidity and expendable financial resources coupled with sustained positive operating margins and stable enrollment.

WHAT COULD MAKE THE RATING GO DOWN

Erosion of the credit rating could result from steep or significant declines in federal appropriations, as well as deterioration in student demand or operating performance. Downward rating pressure could also occur from a material increase in debt.

KEY INDICATORS (FY 2013 audited financial results; fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 1,496 students

Primary Selectivity: 65.5%

Primary Matriculation: 58.9%

Net Tuition per Student: $10,991

Educational Expenses per Student: $66,198 (excludes $29.9 million of Clerc Center expenses)

Average Gifts per Student: $2,976

Total Cash and Investments: $201.2 million

Total Direct Debt: $41.4 million

Expendable Financial Resources to Direct Debt: 1.70 times

Expendable Financial Resources to Operations: 0.42 times

Monthly Days Cash on Hand: 131.8 days

Monthly Liquidity to Demand Debt: Not applicable

Operating Revenue: $169.2 million

Operating Cash Flow Margin: 9.0%

Three-Year Average Debt Service Coverage: 19.37 times

Reliance on Federal Government Appropriations (% of Moody's Adjusted Operating Revenue): 65.9%

Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 22.3%

RATED DEBT

Series 2011 University Revenue Bonds (Gallaudet University Issue): A2

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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